

**ETHICS COMMISSION
CITY AND COUNTY OF HONOLULU**



ADVISORY OPINION NO. 181

This opinion is in response to a request for the Ethics Commission [Commission] to advise a City department whether an employee violated the City's standards of conduct as a result of owning and being an officer of a corporation that obtained City contracts.

The Commission believes the employee committed 1) one (1) violation of the Section 11-103, Revised Charter of the City & County of Honolulu 1973 (1984 Ed.), which requires disclosure of outside interests that may give rise to conflicts of interest, and 2) seven (7) violations of Section 6-1.2(5), Revised Ordinances of Honolulu 1978 (1983 Ed.) [ROH], which requires competitive bidding before the City may contract with businesses in which an employee has a substantial or controlling interest. Therefore, the Commission advises that such disciplinary action as is deemed appropriate may be taken. Pursuant to Section 3-2.4(e), ROH, the Commission requests that it be advised of the disposition of this matter.

The Commission bases this opinion on the following facts:

On (date), the department hired the employee. Before that date, the employee knew that he must terminate his interests in his company [Company X] as a condition of employment. Company X contracted with the City to supply goods and services to the department. On that date the employee completed a CC-8 disclosure form and disclosed no outside employment or other interests. When he did not do so, he failed to disclose that at that time he remained president and owner of 49% of the stock of Company X. He remained so affiliated with Company X until (date), when he came under investigation by the department. Since (date), Company X obtained the following contracts with the City:

<u>Encumber Number</u>	<u>Warrant Number</u>	<u>Warrant Date</u>	<u>Amount</u>
-----	-----	-----	\$-----
-----	-----	-----	-----
-----	-----	-----	-----
-----	-----	-----	-----
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Note: The initial "A" in the encumber number indicates that the contract was subject to competitive bidding; "B" that there was not competitive bidding; and therefore that (number) of contracts between (date), and (date), were not subject to competitive bidding.

The facts above give rise to the following questions presented:

1) Whether a City employee has a a) controlling or b) substantial financial interest in a corporation when a) he owns 49% of its stock or b) he is the corporation's president;

2) If so, whether an employee may contract through the corporation with the City for amounts less than \$500 without competitive bidding; and

3) Whether a presumption of intent not to disclose outside interests arises when a) an employee knows he must terminate financial interests in a corporation as a condition of City employment but b) he does not terminate such interests and c) fails to disclose the continued interest on a CC-8 disclosure form.

Question 1

The first question is whether a City employee has a a) substantial or b) controlling financial interest in a corporation when a) he owns 49% of its stock or b) he is the corporation's president.

The Commission adopts the general rule that an employee has a) a substantial and b) possibly controlling financial interest in a corporation when a) he owns 49% of its stock or b) he is the corporation's president. Whether he owns a controlling interest is a question of fact for the Commission to decide under the circumstances of each case. A "controlling interest" can be less than fifty percent.¹ A "financial interest" includes both an ownership interest or officership in a business,² such as a corporation like Company X.³

Under this rule, the employee had a substantial and possibly a controlling financial interest in Company X during the time it obtained City contracts because 1) he was a 49% owner and 2) he held the office of Company X's president.

Question 2

¹"Controlling interest" means an interest which is sufficient in fact to control, whether the interest be greater or less than fifty percent. Section 6-1.1(5), Revised Ordinances of Honolulu 1978 (1983 Ed), [ROH].

²"Financial interest" means an interest held by an individual, the individual's spouse, or minor children which is: (A) **an ownership interest in a business**; (B) a creditor interest in an insolvent business; (C) an employment, or prospective employment for which negotiations have begun; (D) an ownership interest in real or personal property; (E) a loan or debtor interest; or (F) **a directorship or officership in a business**. Section 6-1.1(6) ROH; Am. Ord. 84-83 (emphasis added).

³"Business" includes (A) **a corporation**; (B) a partnership; (C) a sole proprietorship; (D) institutions; (E) trusts; (F) foundations; or (G) any other individual or organization carrying on a business, whether or not operated for profit. Section 6-1.1(2), ROH (emphasis added).

Because the employee had such financial interests, the second question is whether the City may contract with an employee through a corporation in which the employee has a substantial interest.

The general rule is that City agencies must advertise and obtain written competitive bids for contracts over \$4,000.00; must obtain written competitive bids but need not advertise for contracts between \$500.00 and \$4,000.00; and need not advertise or obtain competitive bids for contracts below \$500.00.⁴ The exception to the rule is that a City agency like the department⁵ may not contract with a business in which an employee has a substantial or controlling interest unless the contract is made after competitive bidding, whether or not the contract price is below \$500.00.⁶ The rationale underlying the exception is that contracts with businesses owned by City employees give rise to appearances of conflicts of interest and thus embarrass the City. In practice, the Purchasing Division of the Finance Department encourages competitive bidding for contracts where the amount is less than \$500.00 and suggests the solicitation of bids by telephone. If a City agency wants to contract for amounts less than \$500.00 with a business owned by an employee, the agency may solicit competitive bids by telephone and contract with the employee or his company after such solicitation.

The Commission has applied the general rule or the exception in one informal and two formal opinions. In Advisory Opinion No. 107 [AO #107], the Commission decided that a City agency may award a contract to a business owned by an employee when that business was the only bidder. In AO #120, the Commission advised a City commissioner that he might sell equipment worth more than \$500.00 to a City department only after competitive bidding. The general rule required competitive bidding because the amount was \$500.00 or more. The exception also required competitive bidding, whatever the amount, because the seller was a City commissioner and therefore City officer.⁷

⁴ Section 9-301.3(b), Revised Charter of the City & County of Honolulu 1973 (1984 Ed.) [RCH], states:

All purchases and contracts for materials, supplies, equipment and services shall be made by advertising, except that such purchases and contracts may be negotiated without advertising if:

...

- (b) The aggregate amount involved does not exceed \$4,000.00; however, any purchases or contracts involving sums between \$500.00 and \$4,000.00 shall be based on competitive bids

⁵ "Agency" includes (A) the City and County of Honolulu; (B) the Council and its committees; (C) **all departments**, offices, boards, commissions, committees; (D) all independent commissions and other similar establishments of the City government; and (E) any other governmental unit of the City. Section 6-1.1(1), ROH (emphasis added).

⁶ No officer or employee of the City ... shall ... [e]nter into any contract in behalf of the City with an officer or employee or with a business in which an officer or employee has a controlling or substantial financial interest, involving the furnishing of services, materials, supplies, and equipment unless the contract is made after competitive bidding Section 6-1.2(5), ROH.

⁷ Section 13-101.4(b).

In the third situation, a City department wanted to hire an employee to provide the service of repairing departmental equipment because the employee was willing and able to do so while other repair services on Oahu were few in number and either unwilling or unable. The estimated cost of repairs at any one time was less than \$500.00. There the Commission advised in an informal letter opinion that the department could hire the employee after soliciting competitive bids by telephone and maintaining a written record of such solicitations.

As a conceptual matter, the words of Section 6-1.2(5), ROH, suggest that a City agency, such as the department, rather than an employee, such as the subject employee, violates this standard by contracting with a business in which an employee has a substantial or controlling financial interest. However, either an agency or an officer or employee may commit violations, depending on the circumstances. In this situation, the department contracted with Company X after the subject became an employee because he had agreed to terminate his financial interests in Company X as a condition of employment. The department was aware of the ethical rules, did not intend a violation to occur, and trusted the employee to take action in accord with his agreement. Because he did not do so, the violation accrues to him, provided he intended not to disclose his continued interests in Company X.

Question 3

Accordingly, the third question is whether the employee intended to deceive the department and thereby violate the standards of conduct. Absent an admission of intent to do so, the question becomes whether a presumption of intent not to disclose outside interests arises when a) an employee knows he must terminate financial interests in a corporation as a condition of City employment but b) he does not terminate such interests and c) fails to disclose the continued interest on a CC-8 disclosure form.⁸

Under Section 11-103, RCH,⁹ the general rule is that all officers or employees must disclose real or apparent conflicts of interest involving a connection between their official duties and their private, called "outside" or "non-City", interests. In practice, employees file an E-2 form at the time a conflict arises and CC-8 form at the time of certain events, such as entry into City employment.¹⁰ When these events occur, the elements of a violation of disclosure laws are then,

⁸ The standards of conduct do not explicitly state either the burden of proof or the state of mind necessary for a finding of violation of the standards of conduct. The Commission believes the burden of proof is that of clear and convincing evidence rather than a preponderance because a finding of violation in this instance is analogous to a finding of fraud or misrepresentation in tort. Similarly, the Commission believes the state of mind is that of intent rather than absolute liability or mere or gross negligence because a finding of violation reflects negatively upon the character of the violator.

⁹ Section 11-103, RCH, states, in pertinent part, as follows:

Any elected or appointed officer or employee who possesses or who acquires such interests as might reasonably tend to create a conflict with the public interest shall make full disclosure in writing to such person's appointing authority or to the council, in the case of a member of the council, and to the ethics commission, at any time such conflict becomes apparent.

¹⁰ Part 1 of the CC-8 form, which the employee completes, states:

1) failure to disclose conflicts of interest and 2) intent not to disclose such conflicts. Notice that intentionally failing to disclose outside interests appears on the CC-8 form and states: "Failure to disclose any outside employment, business or professional activity ... may subject the officer or employee to disciplinary action by the agency head or appointing authority."¹¹

The employee did not disclose on his CC-8 form his interests as an owner and officer of Company X and therefore establishes the first element. The Commission believes that the second requirement of intent is also established by the following facts:

1. The employee knew that he must terminate his ownership of Company X stock and his position as Company X's president as a condition of City employment with the department.
2. The employee did not terminate his ownership or the office of Company X's president.
3. The employee disclosed no outside interests whatsoever on his only CC-8 disclosure.

The Commission believes a presumption of intent arises clearly and convincingly from these facts. Therefore, the Commission believes, the employee intentionally violated the standards of conduct.

In conclusion, the Commission has been asked to advise a City department whether an employee violated the City's standards of conduct when he retained financial interests in Company X after instructions to terminate such interests as a condition of employment. The Commission believes that the employee committed 1) one (1) violation of Section 11-103, RCH, when he failed to disclose his continued financial interests in Company X and 2) seven (7) violations of Section 6-1.2(5) ROH, when Company X contracted with the City seven (7) times after the employee accepted employment and before he terminated his interests in Company X. Therefore, the Commission advises that such disciplinary action as may be deemed appropriate may be taken.

Dated: December 14, 1987

JANE B. FELLMETH
Chair, Ethics Commission

Complete this form within five (5) days of:

1. Entering City employment or office.
2. Promotion or reallocation to a higher position.
3. Transfer from one agency to another.
4. Obtaining any new outside employment or business or professional activity.
5. Seeking approval of or appearances before any City agency.

¹¹See sample CC-8 attached.